

**REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF THE UMSOBOMVU LOCAL MUNICIPALITY FOR THE
YEAR ENDED 30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Umsobomvu Local Municipality which comprise the balance sheet as at 30 June 2009, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2008 (Act No. 2 of 2008) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Fixed assets

4. As a result of incomplete details in the asset register, assets amounting to R59 173 367 not having unique asset numbers and assets not in working condition amounting to R165 978 not removed from the asset register, it was not possible to link the assets to their location, department, cost centre, asset class and asset type. Furthermore, the room asset lists were not up to date and could therefore not be used as an additional source of reference. The municipality's records did not permit the performance of alternative audit procedures and I was consequently unable to perform all the procedures I considered necessary to obtain sufficient appropriate audit evidence as to the existence, valuation, completeness and the municipality's rights to fixed assets disclosed as R62 745 955 in note 6 to the financial statements.

Debtors

5. I was unable to obtain sufficient appropriate audit evidence as to the completeness, existence, valuation and the municipality's rights to debtors disclosed as R40 661 900 in note 9 to the financial statements due to:

- Based on the 2008-09 recoverability testing, a non-payment percentage of 72,32% was determined and accordingly the provision for bad debts should have been R34 487 804. In addition on debtors amounting to R2 134 979, no subsequent payments had been received. The provision was therefore understated, resulting in debtors being overstated by approximately R22 120 227.
- Debtors as disclosed in the annual financial statements differed from the general ledger:

Description	General ledger amount R	Financial statements amount R	Difference R
Debtors	40 606 962	40 661 900	54 938

- The opening balance of debtors as per the general ledger differed from the prior year closing balance as per the annual financial statements:

Description	General ledger amount R	Financial statements amount R	Difference R
Debtors	33 097 138	33 722 113	624 975

- The entity's records did not permit the application of alternative procedures regarding debtors.
- Bad debts written off amounting to R84 320 were not recognised in the financial statements, resulting in debtors disclosed in note 9 to the financial statements being overstated and expenditure being understated by R84 320.

Revenue

- As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the accuracy, completeness, occurrence and classification of revenue disclosed in the income statement:
 - The municipality did not keep an adequate register or reconciled the direct income and rental deposits received amounting to R199 219 with the source documents and the financial system.
 - Interest on assessment rates amounting to R3 084 596 was not calculated and charged on a monthly basis by the municipality. As sufficient appropriate supporting documentation was not available, I was not able to calculate what the interest charge against assessment rates and consumer debtors should have been if interest had been calculated and charged on a monthly basis.
 - The municipality did not keep a proper register or reconciliation of the traffic fine revenue received amounting to R1 401 307.
 - Differences were identified in meter readings and tariffs used to levy water consumption charges during the year. As sufficient appropriate supporting documentation was not available, I was not able to calculate what the charged against consumer debtors and service charges revenue should have been if the tariffs had been applied correctly.
 - Sufficient appropriate supporting documentation was not provided for the meter readings.
- The entity's records did not permit the application of alternative audit procedures regarding revenue.

10. Debit balances amounting to R900 483 was incorrectly allocated to revenue and not classified as debtors in the annual financial statements. Consequently, revenue and debtors were both understated by R900 483.

Value-added tax (VAT)

11. The outstanding VAT liability is disclosed as R8 522 328 in note 11 to the financial statements. As described in paragraph 5 above, I was unable to obtain sufficient appropriate audit evidence regarding the completeness, existence, valuation and the municipality's rights to debtors. Furthermore, the municipality's accounting system was inadequate to account for VAT. The general ledger accounts were thus not used for VAT calculation purposes. Separate spreadsheets were maintained for completion of the monthly VAT returns and a number of journals were then posted to correct the general ledger VAT account balances. Consequently, I am unable to satisfy myself as to the valuation of the VAT liability. The entity's records did not permit the application of alternative audit procedures regarding VAT.

Corresponding figures

12. International Standard on Auditing 710 on comparatives requires the auditor to modify the auditor's report when the matters that gave rise to the prior period modification of the audit report are still unresolved. The prior year audit report contained the following qualification paragraphs that had not been resolved by 30 June 2009:

Description	Amount
Fixed assets	R3 843 282
Debtors	R33 640 120
Revenue	R2 660 813
Creditors	R7 892 089
VAT	R5 514 201
Bank and cash	R497 005

Disclaimer of opinion

13. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the following matters on which I do not express a disclaimer of opinion:

Basis of accounting

14. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

Unauthorised expenditure

15. As disclosed in note 31 to the financial statements, unauthorised expenditure to the amount of R570 444 was incurred, as proper budgetary control had not been followed for the Noupoot projects.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

16. The supplementary information set out in appendices A to F does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Local Government: Municipal Finance Management Act, 2003 (MFMA)

17. The accounting officer did not take effective and appropriate steps to collect all money due to the municipality, as required by section 64(2)(a).

Governance framework

18. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

19. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4	Fixed assets			1		
5 - 7	Debtors	5		1, 6		
8 - 10	Revenue	5		1	1	
11	VAT	7				
12	Corresponding figures	6, 7			1	1

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of	3

personnel.	
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

20. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	X	
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.	X	
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	X	
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines (section 126 of the MFMA).	X	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	X	
Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		

No.	Matter	Y	N
	• The municipality had an audit committee in operation throughout the financial year.		X
	• The audit committee operates in accordance with approved, written terms of reference.	X	
	• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
7.	Internal audit		
	• The municipality had an internal audit function in operation throughout the financial year.	X	
	• The internal audit function operates in terms of an approved internal audit plan.	X	
	• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.	X	
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.	X	
10.	The information systems were appropriate to facilitate the preparation of the financial statements.	X	
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.		X
12.	Powers and duties have been assigned, as set out in section 79 of the MFMA.	X	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		X
Issues relating to the reporting of performance information			
14.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
15.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
16.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and targets as per section 68 of the MFMA.		X
17.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

21. The final draft of the annual report was not finalised and submitted to my office during the time of my audit.
22. The establishment of the audit committee during January 2009 is of critical importance as their role in the monitoring and review of internal control and financial management is critical to the maintenance of the current audit outcome.
23. The fraud prevention plan should be implemented subsequent to a proper risk assessment process within the municipality. Proper internal controls and monitoring structures should also be developed by management to address risks of financial and non compliance nature.
24. The implementation of audit recommendations requires improved monitoring and supervision by management. Action plans developed to address audit outcomes should be monitored and overseen by council supported by the audit committee and internal audit and managed by the accounting officer.
25. With regard to performance information, the following matters require attention:
- The information system framework is not detailed enough to facilitate the preparation of a performance report that is accurate and complete. Furthermore, detailed standard operating procedures setting out the roles and responsibilities of all levels of staff involved in the collection and collation of performance information, from source document to reporting, has not been prepared and communicated throughout the entire municipality. This is indicative of a situation where adequate control processes and procedures were not designed and

implemented to ensure the accuracy and completeness of reported performance information and adequate mechanisms were not established to monitor and review the performance management system as required by section 40 of the MSA.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

26. I have reviewed the performance information as set out on pages xx to xx.

The accounting officer's responsibility for the performance information

27. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA.

The Auditor-General's responsibility

28. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

29. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate audit evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

30. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Findings on performance information

Non-compliance with regulatory requirements

Existence and functioning of a performance audit committee

31. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

32. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

Lack of adoption or implementation of a performance management system

33. The municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

Reported performance information not reliable

34. Sufficient appropriate audit evidence in relation to the reported performance information of the infrastructure development and service delivery and the local economic

development programmes could not be obtained, as the relevant source documentation could not be provided for audit purposes.

APPRECIATION

35. The assistance rendered by the staff of the Umsobomvu Local Municipality during the audit is sincerely appreciated.

Auditor-General

Kimberley

14 December 2009



**AUDITOR - GENERAL
SOUTH AFRICA**